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AFGHANISTAN'S AGENDA FOR ACTION

Developing The Trade & Business Environment

Executive Summary



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EXECUTIVE SUMMARY

Overview

The Afghanistan Commercial Law and Institutional Reform Diagnostic Activity (ACLIR) was conducted in the Afghanistan from February 1- February 15, 2007. This executive summary provides an overview of Afghanistan's historical background; an outline of the ACLIR diagnostic methodology and approach; cross-cutting themes permeating legal and institutional reform policies, and a summary of 17 CLIR subject-matter area findings. The full diagnostic assessment report is available upon request.

Afghanistan: A Search for Self-Sufficiency

Afghanistan is a land-locked Islamic Republic of about 30 million inhabitants located in the mountainous region of Central Asia between Iran, Turkmenistan, Uzbekistan, Tajikistan, China, and Pakistan. It is



predominantly an agrarian economy, and it has been long considered a loose confederation consisting of disparate peoples separated by harsh terrain, language, local politics, and tribal affiliations. Over the past thirty years, a series of civil wars and external invasions have caused significant civic and physical

destruction. In late 2001 the U.S.-led ouster of the ultra-Islamic Taliban from Kabul led to significant changes. Although the current Constitution of Afghanistan is only three years old, a violent insurgency has yet to be rooted out from the Southern portion of the country, mostly along its border with Pakistan.¹

Billions of dollars of international aid have been spent on Afghanistan and billions more are promised. Afghanistan has joined a number of significant international conventions on trade and finance and has constitutionally committed itself to a market economy. Afghanistan has proposed aggressive and reform-oriented goals in its Afghanistan National Development Strategy. Most agree that the goal of outside aid is to support the development of a free, prosperous, friendly and self-sustaining Afghanistan. The question is, "When will that happen?"

Short-term economic prosperity can lead to growth. Self-supported sustainability, however, is the key to productive long-term economic and national prosperity. An economy with the ability to address the needs of its populace will enjoy stability and respect creating an environment for improved international trade. An elected government that serves Afghans with the basics of human necessity – while enabling a necessary degree of personal and economic self-determination – will enjoy legitimacy, stability, and international clout. This type of government and economy will be mutually reinforcing and will ultimately be responsible for rebuilding a strong and self-sustaining Afghanistan.

An instant Diagnostic of the current state Afghanistan's environment for Commercial Legal and Institutional Reform (CLIR) and Trade (referred to as "ACLIR Trade" or "Diagnostic") cannot directly answer the question of "when." If one accepts, however, that the rule of law is a critical foundation

¹ Photo credit: CIA World Factbook 2007.

for legitimate business and honest government, the findings herein can be of enormous value. Not only does the full Diagnostic cover the “nuts and bolts” of Afghanistan’s commercial law framework, but it also discusses general mechanisms and specific features of Afghanistan that impact the underpinnings of a strong economy. These include, among many examples: Afghanistan’s comparative advantages in agriculture and regional trade; post-authoritarian mindset and its impact on exclusion of free press and consequently greater public ignorance; and the impact of Islamic banking on the development of domestic investment.

Such analyses are useful not only as a snapshot of where Afghanistan is today with respect to its commercial institutions and legal framework, but also as a tool for deciding how, where, and when help should be offered. The full Diagnostic recognizes that there are few easy answers and that important decisions will require a balancing of competing interests and overlapping dynamics.

The ACLIR-Trade Diagnostic: At the Heart of Central Asia

The Afghanistan Commercial Legal and Institutional Reform (ACLIR) Diagnostic is the first of its type to be conducted in nearly five years in the heart of Central Asia.² Afghanistan is bordered by a number of economic and geopolitical actors – Iran, Pakistan, and Tajikistan, among others – who represent emergent interests and dynamics in the spheres of global development, energy security, and international trade.

Applying the comprehensive methodology established through USAID’s Seldon Project for Global Trade Law Assessment and Assistance³. The full Diagnostic examines the following topics:

1. Islamic Law (*Shari’ah*)
2. Company Law and Corporate Governance
3. Contract Law and Enforcement
4. Real Property Law
5. Secured Transactions Law
6. Bankruptcy
7. Commercial Dispute Resolution
8. Court Administration
9. Competition Law and Policy
10. Opium Poppy
11. Foreign Direct Investment
12. International Trade Law
13. Flows of Goods and Services across Borders
14. Trade-Related Financial Flows
15. Trade-Related Flows of People
16. Financial Crimes
17. Intellectual Property

The purpose of focusing on these subject-matter areas is to identify in specific and substantive terms the various ways in which a country may not capitalize on opportunities for economic growth because of its law, policies, institutional characteristics, or social dynamics, and how specifically it might capture and realize those opportunities. Sustained efforts to address these topics can increase a country’s prospects for economic growth and prosperity. Raising prosperity over time requires legal and institutional changes that allow economic actors to establish themselves, grow, compete, resolve conflict, access markets, and engage in free trade with relative ease. Although every country has specific needs and priorities, research points to a number of “best practices” in successful implementation of economic reform.

Taking data from a broad spectrum of stakeholders, and looking through the following lenses, the Diagnostic builds a “360° picture” of Afghanistan’s commercial law and trade-related institutions.

² Previous Diagnostics in the region include Armenia (2001); Azerbaijan (2002); and Kazakhstan (1999).

³ Detailed information about the Seldon Project can be found at www.bizlawreform.com.

Legal Framework. The Diagnostic first examines the laws and regulations that Afghanistan has in place that serve as the basis for their ability to achieve and sustain market-based development. The Diagnostic poses the following questions: *How closely do existing laws reflect emerging global standards? How well do they respond to commercial realities that end-users face? What inconsistencies or gaps are present in the legal framework?* Often discovered through this review are opportunities to make relatively small changes that may result in significant openings for business development and expansion.

Implementing Institutions. Next, the Diagnostic examines those institutions that hold primary responsibility for implementation and enforcement of laws, regulations, and policies governing one or more of the areas addressed in this Report. For example, courts are usually a crucial institution in the examination of commercial law. Problems uncovered often relate to bureaucratic inefficiency, lack of resources and training, and, of paramount concern, real or perceived corruption.

Supporting Institutions. The Diagnostic then considers the environment of organizations, individuals, or activities without which the legal framework or policy agenda cannot be fully developed, implemented, or enforced. Examples include notaries, lawyers, banks, business support organizations, professional associations, universities, and other ancillary service providers. Of particular interest with respect to supporting institutions is whether they have any meaningful involvement in *what the law says*. Where there has been “buy-in” from affected constituencies, a law and its commensurate system for implementation are more likely to be understood and used properly, and to achieve their overall purpose.

Social Dynamics. Finally, social dynamics are studied to determine whether the affected constituencies of a law or policy perceive a need for change, and, if so, how they are demonstrating this need. Are they effectively lobbying those institutions that can make a change? Is the media seizing the issue as a topic of public concern? Are individuals speaking

out? Or, have social dynamics taken a less positive approach – for example, is the “gray economy” growing as a response to overly burdensome conditions for market entry? Analysis of social dynamics may affect how an assistance project is ultimately designed. Where outside participation is strong and inclusive, and public understanding high, a reform program may simply involve a relatively small number of government officials who are capable of meeting the demands. In contrast, where mistrust and misunderstanding are abundant, an approach that involves significant engagement of “end-users” will likely be necessary.

The ACLIR-Trade Diagnostic was conducted by a team of commercial law and trade professionals, including a representative from USAID/Washington, DC, who traveled to Afghanistan to conduct a comprehensive inquiry into the country’s laws, public and private sector institutions, and social dynamics relating to commercial law and trade. The team consisted of the following members:

- Peter J. Baish (Flows of Goods and Services across Borders, Trade-Related Flows of People)
- Michael F. Cardoza (Competition Law and Policy, Foreign Direct Investment)
- Wade Channell (USAID) (Commercial Dispute Resolution, Court Administration)
- J. D. Crouch (Administration, Logistics, Security, and Introduction)
- Bikramaditya Ghosh (Team Leader)
- Thomas N. Jersild (Company Law, Real Property Law)
- Kenneth G. Swanberg (Opium Poppy, Trade-Related Financial Flows, and Financial Crimes)
- Andrew White (Islamic Law, International Trade Law)
- Louise D. Williams (Contract Law and Enforcement, Intellectual Property)
- The Honorable Michael G. Williamson (Secured Transactions Law, Bankruptcy).

Cross-Cutting Themes in Legal and Institutional Reform

Certain themes and dynamics are so prevalent across the analytical framework that they bear special mention. They can be thought of as layers. For example: the full Diagnostic is organized so that the typical components of a healthy civic society and a prosperous economy are discussed discretely and then related to each other where appropriate. This structural format reflects much of the Western mental construct about civil society and an individual's relationship to the state and other organizations. Concepts such as "church and state," "public and private," and "principle and agent" are so ingrained in the West that they are often deemed to be actually distinct entities and concepts. In Afghanistan, this is not the case. There, different relationships, authorities, sources of law, duties, and responsibilities are often conceptualized as a seamless whole – as "society."

Thus, in order to appreciate the true impact of the unique themes that permeate the findings and recommendations in this Diagnostic, it is important to keep in mind that they not only overlap and affect all of the separate analytical areas, but each other as well. For example, a lack of literacy creates a dependence on oral transmission for information, usually from a trusted source who has some familial and, quite likely, religious stature. In this case, information about something as mundane as a market price may come blended with a religious and micro-community component that would not otherwise be available to everyone reading the same secular newspaper.

Against this backdrop, a number of cross-cutting themes emerged during the course of the Diagnostic. They may be characterized as follows, and are discussed in turn: (a) the tension between the urgency of creating a legal framework that will support a genuine market economy, and the legitimacy of laws that are enacted without a broad-based effort to build consensus and educate stakeholders; (b) the grave challenge of rebuilding implementing institutions; (c) the scarcity of

knowledge and understanding underlying key supporting institutions; and (d) the clear opportunities that currently exist in Afghanistan's business environment.

A. "Urgency vs. Legitimacy"

Many development professionals take the view that Afghanistan needs **modern civic institutions** in order to build a vibrant and self-promoting middle class, and that development aid should be used to build those institutions. A second vision of long-term, sustainable development holds that successful civil societies emerge from knowing and participatory consent between the governed and the system of government.⁴ Easterly contends that legitimacy of law, and ultimately the long-term prosperity and stability of a nation, depends on the degree to which its citizens have committed to the program by either creating it in their own vision or by being an assenting partner to the compromises that resulted in its ultimate form.⁵

At the time of the Diagnostic, ten commercial laws had been prioritized for enactment over the next calendar year through the Afghanistan National Development Strategy, an effort subscribed to by the government but largely led by the donor community.⁶ These laws are supposed to undergo a process of review by the Afghan Ministry of Commerce and the Taqnin (the legislative drafting

⁴ See, e.g., William Easterly, *Planners vs. Searchers in Foreign Aid* (Paper prepared for ADB Distinguished Speakers Program, January 18, 2006), at 23.

⁵ It is argued that a program of legal reform should be a dynamic activity that "includes research, debate, negotiation, public education, outreach, institutional capacity building in parliament, revisions of drafts based on local political compromises and a host of other steps." Wade Channell, *Lessons Not Learned: Problems with Western Aid for Law Reform in Postcommunist Countries* (Carnegie Paper No. 57, March 2005) at 9.

⁶ See Ministry of Justice and National Assembly, *Prioritized Legislative Agenda for 1386 and Legislative Capacity Needs of Ministry of Justice and National Assembly* (January 30-31, 2007), found at <http://www.and.s.gov.af/ands/jcmb/src/jcmb4/eng/05%20-%20MoJ%20%20P L%20Agenda%20&%20Annual%20Legislative%20Plan%20-%20JCMB-IV%20Folder%20-%202024%20Jan%20-%20Eng ish.pdf>.

unit of the Ministry of Justice) and to be reviewed by the U.S. Embassy in Afghanistan and other U.S.-sponsored advisors. Revisions are to incorporate comments from each of those reviews, when necessary. In January 2007, four of these laws (the Company Law, the Partnership Law, the Arbitration Law, and the Mediation Law) were signed into effect by the President during the Parliamentary recess – an act not without its controversies. The Contracts Law, according to most observers, is next in line. The remaining five laws slated for near-term enactment include three intellectual property laws (Copyright, Trademarks, and Patents), a Law on Agency, and a Law on Standards.

The urgency with which this agenda is being pursued contributes to the following observations about the ultimate ability of the emerging legal framework to be considered legitimate by the Afghan people. As detailed over the course of this Report:

- The **Company Law**, signed by the President in January 2007, was written by foreign lawyers who did not spend substantial time in Afghanistan and received little (or no evident) review or input from Afghan companies, businesspeople, or professional persons such as lawyers, accountants, and judges. Local actors, including a ministry senior lawyer and lawyers who represent a major Afghan company, reported that they are unaware of the new law or its contents, that they have not seen a draft of it, and that they would like to have had – and would now like to have – substantive input.
- The **Contracts Law** was drafted chiefly by outside advisors in 2003 and 2004. Since that time, local lawyers, judges, businesses, law professors, and other critical constituencies have not been consulted about its contents – or even informed about it – to any significant degree. The new law reflects this lack of consultation insofar as it does not yet provide any guidance about the process for contract enforcement. Furthermore, the law was not constructed in conjunction with a meaningful plan for implementation, including how law students and existing lawyers will learn to write and enforce contracts. In the Afghan marketplace, there continues to be only nominal use of contracts, and those companies that do use them have little appetite for taking disputes to court. How the new law will integrate with this reality has not been planned for in formal terms.

- A review of the **three draft intellectual property laws** reveals that, three years after they were prepared by outside experts, there is no local consensus concerning how they are to be implemented or enforced. In fact, the draft laws at once suggest the establishment of a single office to handle all types of intellectual property, while simultaneously indicating such possible sources of discrete administrative authority as a new Trademark Office, a copyright office within the Ministry of Information and Culture, and, for registration of international patents, an office to be named later.
- Although certain of Afghanistan's newer laws or draft laws exhibit strong **compliance with the traditions and expectations embodied in *Shari'ah***, a common theme during the course of the full Diagnostic was that many legal drafters – foreigners in particular – appear to either disregard *Shari'ah* entirely or regard it as irrelevant in their drafting efforts. In discussions with members of the Afghan academic, legal, and business communities, and with various international consultants, voiced the following concerns:
 - Most outside consultants consider the Constitutional requirement of *Shari'ah* compliance as merely political and not a substantive legal requirement;
 - The typical international advisor is not an expert on Afghan culture, law, or *Shari'ah* compliance;
 - Even those laws that mention *Shari'ah* compliance do so in a merely perfunctory manner and not as a substantive consideration;
 - *Shari'ah* is a factor in a number of commercial areas and, if it is not considered adequately, the implementation and long-term use of the commercial laws is jeopardized; and,
 - As one business leader in Kabul put it, "Afghanistan is not America, Pakistan or Europe." *Shari'ah* and other Afghan moral, religious, and sociological factors need to be taken more into account in drafting new laws.

A contrasting example of how outreach and consensus-building can lead to a greater sense of legitimacy can be found in the process used in the development of the land policy, which will ultimately incorporate land-related law, regulations, and practices. The policy was developed with the participation of relevant government representatives,

including officials at the Ministries of Urban Development, Agriculture, and Justice, mayors and other local government officials, private investors, and community members. It proceeds with assistance and coordinating help from the USAID-sponsored Land Titling project. A draft of the policy was approved in February 2007 by the three ministries identified above and the Economic Committee of the Cabinet, whence it is expected to go to Parliament for approval. The various constituencies have been working together in this process for more than a year with multiple meetings and workshops at which there was “plain talk and argument” (quoting one interviewee). According to interviewees, consensus and compromise views have emerged on many issues. Thus, to a far greater extent than the ANDS-prioritized commercial laws, Afghanistan's land policy offers significant potential for public understanding, support and compliance.

In short, and in light of these observations, critical questions arise: *Is Afghanistan in such a state of emergency that what are essentially “foreign” concepts and institutions should be substituted for home-grown ones that might sprout later? Will these institutions and concepts last? Are they appropriate (e.g., compliant with Islamic Law)? Will they emasculate the legislature? Will they alienate the people? Is some kind of foundation – wherever it comes from – a necessary predicate to the ultimate creation of indigenous Afghan institutions?* Thus the argument unfolds in terms of **urgency versus legitimacy**, and these questions form the core of the debate running every day through every level and facet of the Afghan development effort. Do we give them what they need, or help them build what they want, or both?

B. Implementing Institutions: The Challenge of Rebuilding

Afghanistan's suffering in recent years places its implementing institutions – including ministries, courts, and other major agencies – at a level that is almost worse than having nothing at all. Observations of the state of various institutions include the following:

- Afghanistan is currently rebuilding its **courts**. Though once respected for efficiency and general trustworthiness, years of Russian interference, civil war, and Taliban domination took a severe toll on the judiciary. At present, there is widespread perception of corruption in the formal court system, along with indications that the perception is not unfounded. Starting judges earn \$50 per month – far below basic needs – yet over 700 candidates applied recently for 170 judicial vacancies. Anecdotal evidence suggests that the positions are highly desired because of their potential for earning rents, and some judges have indicated that positions are for sale.
- Various **ministries** discussed in the full Report are responsible for drafting and implementing new laws. Many of these ministries simply lack the human capital and resources to realize their nearly overwhelming agenda. Due to habit, personal agendas, and lack of resources, information-sharing among the ministries is said to place grave constraints on progress.
- With respect specifically to trade, the **Ministry of Commerce** and **Ministry of Foreign Affairs** take the lead in matters of international trade. At the time of this Diagnostic, however, the respective roles of each and the lines and parameters of authority were unclear. While the Ministry of Foreign Affairs, for example, initially took the lead in implementing the WTO accession process in 2003, that responsibility shifted to the Ministry of Commerce in July 2005 because literally no action had been taken (not even meetings). Of course, the bi-cameral **National Assembly** (the *Wolesi Jirga*, or House of People, and the *Meshrano Jirga*, or House of Elders) will have a legislative role in international trade matters, but this power has not yet been exercised and has yet to be seen. Similarly, the role of the **President** in international trade and treaties, as executive, is anticipated to be considerable, but specifics are still unknown. Often repeated during the course of the Diagnostic was the suggestion that accession to the World Trade Organization will have to wait until more of the institutions that will necessarily be involved – from the Ministry of Commerce to the Customs agency and others – are more able to comprehend, integrate, and implement a program of WTO compliance.
- The **Afghanistan Customs Department (ACD)** is the principal government agency for border control and is part of the **Ministry of**

Finance (MOF). In general, these institutions are weak, lacking in coordination, inadequately resourced, and marked by corruption. Although Afghanistan has made some progress toward stability, these agencies lack competent staff to provide even basic services and functions.

On the other hand, certain institutions set a promising stage for the future:

- The **Afghan Investment Support Agency (AISA)** arranges the registration of most companies with the commercial court, issues investment licenses, and maintains a license database. AISA is the primary and best investment-information and investment-support body in Afghanistan. Its staff is knowledgeable and helpful, and it is a good resource for significant-sized potential investors, both for company registration and for navigating the system generally. It has an modern website. In the future, it could serve as the “one-stop shop” that oversees a company’s application for specific industry and sectoral licenses. It would undoubtedly also be a good source for comment on the text of the new Company Law.
- Afghanistan has a long cultural tradition of dispute resolution through local councils known as **shuras** (Dari) and **jirgas** (Pashto). While there are some historical differences between the two, both are traditional councils of elders that can be convened by parties to resolve conflicts. The types of cases brought before these councils tend to deal primarily with family law (particularly marriage), inheritance, and local property disputes, but commercial claims also appear on occasion. The *shura* is the only adjudicatory system in Afghanistan that enjoys the respect of the general population. It is used by Afghans because it works better than the courts: *shuras* are perceived to be cheaper, faster, more just, and more trustworthy. As a consequence, for commercial purposes, most Afghans prefer the *shura* system to the judicial system. Even upper-level members of the business community in Kabul reported the use of *shuras* to resolve commercial disputes.

In general, for most practical purposes, Afghanistan **lacks the basic institutions** upon which a middle class depends. Laws, courts, schools, credit, electricity, information, security, transportation, and other institutions are impaired. Commerce mostly occurs at either end of the spectrum – informal micro-enterprise (survival trading and subsistence

farming) or large international investment – at the expense of the middle. This gap is not unrecognized, and progress is being made; however, the importance of building the Afghan middle class cannot be overstated. It is axiomatic that a **middle class** is critical to the stability and prosperity of a modern nation. The middle class are the managers, producers, regulators, traders, teachers, voters, and consumers that make a market economy function. However, as a result of the fundamental weaknesses in implementing institutions, the middle class currently have nowhere to thrive in Afghanistan.

C. Supporting Institutions: A Scarcity of Knowledge

Returning to the theme of “layers,” almost three decades of authoritarian (Communist and Islamist) rule and war have shaped and informed the values, beliefs, and practices of the Afghans who survived it. The **post-authoritarian “hangover”** has left the average citizen, and supporting institutions usually constructed by a society to help economies grow, deficient in personal and economic initiative. Years of having to ask permission and of harsh punishment for unauthorized actions, however insignificant, have given rise to a **“decree” mindset** in which people will normally not act unless explicitly or implicitly told that they may do so. Authoritarian rule is also partly responsible for the **primacy of personal authority over positional authority** – a handicap in trying to build effective institutions governed by the rule of law. Another legacy of authoritarian rule is the seemingly intractable **combination of business and government**, both in reality and in the minds of Afghans. The control levied on information by the authoritarian regimes in the recent past and the danger presented by standing out from one’s peers are also partly to blame for the **general lack of information** present in Afghan society at large. For example, the media is typically feared and shunned by businesses and government alike – there is little to no appreciation of their potentially positive contribution. Another common paradigm is that – whether from family, tribe, government, religious sources, international or donor inputs, or a combination thereof – **rules and laws**

come from “somewhere else.” There is consequently little sense of individual participation in civic society. The notion that people could decide for themselves, via representative government, what rules to follow, does not exist.

There is a marked **lack of information** in Afghan society generally. Some of that deficiency is attributable to the authoritarian experience described above, while some of it is attributable to the lack of literacy and education discussed below. Much of it is likely attributable to the lack of information itself. Afghanistan is not a culture of widespread information. There is no commonly held expectation of knowledge or feeling of entitlement to know things beyond the information incident to daily life and religion. From that lack of expectation seems to have followed a stunting of curiosity. There are few available statistics or even raw data relating to business, government, or the economy. Rumors are rampant, but they have not fueled the market for “ground-truth.” Television and radio are dominated by entertainment programming and there is little incentive for the government to produce and disseminate information as a public good. There is, moreover, no credit information bureau, despite the fact that bad-credit risks are known to many in the banking industry and that they represent a threat to the profits of all bankers.

There is a significant **lack of human capital** in Afghan society today. Educational institutions fell victim to the civil wars following the Soviet withdrawal in the late 1980's and were then systematically savaged by the Taliban in the late 1990's. (What remains of the educational infrastructure is largely colored by Communist doctrine held over from the 1970's and 1980's.) The national **literacy rate is less than 40%**. This means that, aside from radio and television (which both depend on technology and electricity), there are no media for sharing a common understanding. There is little appreciation for an objectively neutral authoritative text – such as a law or tax regulation, because most must have it read to them. There is also painfully little quantification in a society where **numerical literacy** is not any more widespread

than written literacy. This lack of numeracy has major implications for the growth and government of a complex society, from management and promotion of a market economy to the collection, recordation, and expenditure of tax revenue, to even the simplest of business decisions. There is also a lack of



understanding about the **role of public servants**. Government was long a place to accumulate wealth and power at the expense of attention to fiduciary responsibilities.

The lack of human capital is pervasive and its **effects are multi-fold**. For example, a dearth of professors who can teach market economics results in a concomitant lack of businessmen, government functionaries, intermediaries, and price-wise consumers who make up the functioning market economy that is so critical to national self-sustainment. The lack of domestic human capital also fuels imports of human capital from neighboring countries for critical functions, thereby decreasing the “Afghan-ness” of the economy and marginalizing what would otherwise be an indigenous middle class (with perhaps predictably negative consequences to government stability).

Women comprise almost 50% of Afghanistan's population – and they **work**. While businesswomen in the formal sector do exist, most women work in the home without remuneration. Barriers to their

entry into the mainstream of the economy are numerous and include the following: social constructs, traditional gender roles, domestic chores that remain labor intensive due to lack of modern appliances, lack of higher education, and a literacy that is less than half that of males.⁷ Pioneering female entrepreneurs are mostly widows who are thus able to negotiate and otherwise speak for themselves in the business context. Banks, government offices, and other institutions critical to business are getting used to dealing with women professionally. The greatest hope for bringing this underutilized part of the workforce to greater capacity may lie in the reinvigoration of the carpet industry and agricultural processing.⁸

D. Opportunities for the Future

Although much of the information pertaining to Afghanistan's business environment does not paint a positive picture, the Diagnostic team found many promising areas of change, growth, and opportunity. These include the following:

- **Sharī'ah-based lending** may represent a powerful force behind economic growth in the future. Loans are structured to assure compliance with restrictions imposed by *Sharī'ah* prohibiting the collection of conventional interest. Lenders have been able to obtain *fatwas*⁹ assuring borrowers that a type of transaction is in compliance with *Sharī'ah*. A typical *Sharī'ah*-compliant loan is a *murabaha* loan, that is, a "buy/sell" arrangement. Under such an arrangement, the lender buys the item to be financed directly from the vendor. The lender then resells it to the borrower at a mark-up. Because the lender only derives a profit from the mark-up on resale and is paid that amount without interest, there is no "*riba*" or interest involved in the transaction, and it does not run afoul of the *Sharī'ah* prohibition from the collection of *riba*.
- Another area that has seen immediate acceptance and growth is the **leasing of equipment**. This has obvious advantages. First, this simplifies repossession rights because the title stays in the

name of the lessor-finance company. Second, there is no interest involved (at least not outwardly) and therefore, the transaction does not violate the *Sharī'ah* principle against charging interest. Even though in substance these transactions are economically identical to secured financing, their being classified as leases gives them advantages in marketing and enforceability.

- The new **Law on Contracts** is clear, well written, and consistent with both *Sharī'ah* and international best practices. When the process of implementation begins in earnest, it has the potential to serve as an excellent tool for teaching the fundamental principles of modern contract law.
- A significant opportunity relating to Afghanistan's Counter-Narcotics Strategy is the development of **large-scale agri-business**. Given the products produced in Afghanistan before the conflict and since, the potential for such enterprise certainly exists. Of course, it is difficult to suggest this opportunity against a backdrop of constant droughts, harsh winters, wars with the Taliban and Al Qaeda, religious conflicts, lawlessness, and underdeveloped transportation, electric, and sewage infrastructures. Yet agri-businesses are beginning to flourish, the rule of law is improving, finance systems are evolving, and goods are beginning to move.

Indeed, there is, within these examples and in many others set forth in this Report, hope in Afghanistan.

Summary of Subject-Specific Findings

The findings of the 17 subject-matter areas examined in the ACLIR Diagnostic are summarized as follows:

Islamic Law (*Sharī'ah*). Afghanistan is by Constitutional definition an Islamic Republic, one whose laws and government are legitimate only to the extent that they do not conflict with *Sharī'ah*. Laws currently in force exhibit a significant degree of secular "assistance," as do draft laws currently pending enactment. While it is likely that outside help will not be overtly rebuffed by Afghanistan, it is also quite predictable that laws that are not *Sharī'ah*-compliant will not be enforced, thereby eroding respect for and universal application of the rule of

⁷ CIA World Factbook 2007.

⁸ Photo credit: Michael F. Cardoza, personal collection.

⁹ A *fatwa* is a legal pronouncement made by an Islamic scholar on matters involving the *Sharī'ah*.

law. Afghanistan, and other countries in the region, are finding that *Sharī'ah*-compliant banking and business are enormously compatible with realizing profit and the growth of economy generally. On the other hand, to be viewed in the long-term as a destination where outsiders feel comfortable doing business, Afghanistan is challenged with incorporating Islamic law in a way that is not perceived as unduly complicated, biased against foreigners, or unpredictable.

Company Law and Corporate Governance. A simple yet effective Company Law is one of Afghanistan's best bids for bringing informal business into the formal sector where it can enjoy state promotion, protection, and recognition (and the payment of taxes). Afghanistan's new Company Law brings modern international best-practices to what was an unwieldy and often impenetrable legal regime. Due to foreign assistance in drafting, some of its idiosyncrasies are not entirely appropriate for Afghanistan's circumstances, but are none that significantly detrimental. The Company Law holds room for further improvement, particularly in the areas of continued reduction of the impact of state bureaucracy on business.

Contract Law and Enforcement. From a Western perspective, Afghanistan's existing Contract Law is biased in favor of releasing parties from their contractual obligations. Much of this dynamic is derived from tradition and custom, some is derived from *Sharī'ah* compliance. In many cases, the law codifies an "at-will" contract where performance is conditioned on continued mutual assent. Not unsurprisingly, mechanisms for enforcement or damages in the event of breach are stunted. A draft Contract Law represents a major step into formalizing and mainstreaming the informal economy by taking business arrangements out of the minds of the dealmakers and putting them onto paper. Yet the absence of overall policy or specific plans for implementation – in the business community, among lawyers, in the law schools, and elsewhere – threatens to create a law without context and that is destined to disappoint.

Real Property Law. Real Property Law is the underpinning of a modern, middle class, credit-based consumer society. An unambiguous, officially recognized, and transferable title to real property provides the basis for borrowing money secured by that property – money that then in turn fuels the economy. Afghanistan's land laws and practices are extremely complex and often unclear. Moreover, Afghanistan has never had a reliable, standardized system of land titling. The consequence is that, today, commercial land use and investment present obstacles to future economic development.

Secured Transactions Law. The presence of a working legal system for the enforcement of a lender's rights to its collateral upon the borrower's default is central to a mature economy with a strong commercial lending sector. A well understood and efficient Secured Transactions Law – combined with a judiciary that is well versed in commercial law and is perceived to be fair, speedy, and transparent in the enforcement of commercial rights – is an essential component of such a system. Unfortunately, at this stage of its development, Afghanistan has neither a statutory framework nor a judiciary that can be relied upon for the enforcement of a lender's collateral rights.

Bankruptcy. While there are provisions of existing law in Afghanistan that deal with insolvency and the winding up of business enterprises, they are generally unknown even among lenders. In practice, bankruptcy is nonexistent as a viable method of dealing with insolvency in Afghanistan. Inefficient or nonexistent bankruptcy systems prevent the redistribution of income-producing assets and employees, with an overall negative impact on the local communities in which previously solvent businesses once operated.

Commercial Dispute Resolution and Court Administration. For the formal systems of adjudication, the overall legal framework is reasonably sufficient to support the needs of the developing economy, when it is applied. There are some gaps, but the basic system of commercial procedure – on paper – will not need substantial

amendment for some years. Arbitration and mediation have formally been introduced through the recent adoption of new laws, and these should also be adequate for this stage of development. The institutional structures are not so robust. Not only did government institutions and civil society organizations retreat or disintegrate during the war years, the underlying educational system was badly damaged as well. As a result, many of those responsible for the administration of justice have minimal educational and practical qualifications to fulfill their roles. As the schools are re-established, new and better qualified judges and lawyers will be available.

Competition Law and Policy. Competition Law, known commonly as “Anti-Monopoly Law,” is the body of rules designed to promote business competition by preventing domination of any one market by any one enterprise. Afghanistan does not currently have a Competition Law, nor does it have many of the developed markets or market players that might give rise to the need for a Competition Law. There are a number of unique social dynamics that constrain business competition. Work in these areas could ultimately help build a vibrant domestic economy that might one day benefit from such a body of law.

Opium Poppy. Afghanistan's opium poppy narco-economy constituted 36% of the licit GDP in 2004/2005. It permeates the entire economy and the culture of the country, contributing to massive corruption, undermining public institutions, and hindering the development of the rule of law. The licit economy is growing, however, and some of the legal instruments needed to combat the narco-economy are nearly in place. The goal of eliminating opium poppy production, or at least of making the impact of the narco-economy negligible, is near at hand and fully achievable, assuming that the right development instruments are supported and the political will to sustain them is manifest.

Foreign Direct Investment. Foreign direct investment has grown dramatically in Afghanistan over the past four years but it has thus far failed to

deliver on its promise to grow the business infrastructure of a self-sufficient Afghan economy. Afghanistan remains largely a nation of raw exports and re-exports of goods made elsewhere in Central Asia and beyond. Although the legal framework appears to support predictability in investment and return, a lack of supporting institutions and underlying social factors conspire to make Afghanistan's climate for foreign investment less attractive than those of the comparable alternatives.

International Trade Law. There is no specific “trade law” in Afghanistan. Many of the trade laws and regulations typical in developed countries are non-existent in Afghanistan. Tremendous impediments to international trade must first be overcome. For example, the deplorable security situation discourages investment in the critical infrastructure of international trade and discourages travel and transit overall. The absence of commercial laws drafted and implemented to the standards of the international marketplace will severely hamper Afghanistan's progress toward becoming a meaningful international trading partner.

Flows of Goods and Services across Borders. In April 2005, a new Customs Law came into effect in Afghanistan. The law reflects effective modern Customs practices, such as organizational structure, seizure and penalty authority for Customs violations, collection of foreign trade statistics, joint facilities with neighboring countries, and the acceptance and the use of electronic data for Customs documentation. However, conditions at border ports remain chaotic, with poor security, thefts, and many unauthorized individuals offering both legitimate and illegitimate services. Import processes, despite improvements, continue to be complex and burdensome, leading to delays and increased costs. WTO accession is a new topic to both the government and private sector of Afghanistan; as a result, accession is often treated with apprehension fueled by a lack of basic understanding and misconceptions about its potential impact upon Afghanistan's foreign trade regime and Customs collections. Enactment of a GATT-compliant statute and the issuing of the defining and implementing

decrees are important steps in WTO accession that remain to be accomplished.

Trade-Related Financial Flows. Access to money is unconstrained, and transferring money in and out of the country is relatively easy and uncontrolled. The Central Bank is mandated to carry out the basic operations of a central bank, including foreign exchange controls and regulating the flow of money, although the monitoring of exchange practices has been limited to date. Laws are being prepared, and in the process of being enacted, for regulating trade financing, documentary credits, and various forms of financial instruments. However, the laws do not reach as far as regulating international trade financing or providing for insurance for financing transactions. Foreign investors are allowed to operate in Afghanistan and trade and investment financing is not considered to be unduly complicated or cumbersome.

Trade-Related Flows of People. Trade-related flows of people to Afghanistan are very limited at this time because the security environment remains volatile and unpredictable. Tourism (except so-called “extreme tourism”) is out of the question. The ability of Afghan authorities to maintain public safety and order while ensuring the security of citizens and visitors is limited. Even though the capital of Kabul is considered fairly safe, extreme caution is advised in U.S. State Department and other foreign government travel advisories. Elsewhere in Afghanistan, a significant increase in attacks in the south and southwestern areas of the country has occurred, and a seasonal surge in insurgent activity is expected. Violence and the threat of violence are restricting trade development in many parts of the country, cutting off work opportunities for Afghans and those wishing to invest in Afghanistan. Despite low trade-related people flow in Afghanistan, key infrastructure improvements have been made and more are planned. Over \$8 billion in aid and investment from

the international community has greatly improved Afghanistan's prospects for the future. As needed stability is achieved, these improvements will allow for larger numbers of cross-border, trade-related travel.

Financial Crimes. Financial Crimes – namely, money laundering and terrorist financing – seem to run unabated throughout Afghanistan. Opium poppy is a \$2.7 billion illicit industry. Some of the warlords and local militia have now become “traffickers,” “protectionist groups,” or “terrorists,” receiving some or all of their financing from the opium trade. Given this situation, the government is attempting to introduce anti-money laundering legislation and combat terrorist financing through improved law enforcement. An Anti-Money Laundering/Combating the Financing of Terrorism (AML/CFT) framework and corresponding laws are in place; however, the system of financial crimes detection and prosecution is just beginning – no apprehensions or prosecutions have been made to date.

Intellectual Property. In Afghanistan, the IPR tradition is wafer-thin, existing almost exclusively in the arena of trademarks. Works that may be subject to IPR protection in other economies – such as books, CDs, computer software, and visual designs – tend to be freely accessed and copied without payment or attribution. The fact that Afghanistan's economy is so small, however, means that this issue presents far less of a threat to international commerce and foreign investment than it does in many other countries. Whether now is the time to drive for a comprehensive system of IPR registration and enforcement in Afghanistan is a threshold question that has not yet been fully examined by the Afghan government or the donor community. Afghanistan faces the challenge of “selling” an IPR regime to a general public that has an unusually high rate of illiteracy and an enormous urgency to simply avoid the daily perils of poverty.

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